

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:VWV:RCH:TL-N-3894-99
CMDRees

date: SEP 03 1999

to: Chief, Examination Division, Virginia-West Virginia District
Attn.: Tyrone Hicks, Manager, Group 1115

from: CHERYL M.D. REES
Attorney

subject: Computation of Interest on Deficiencies In the Context of
Credits Elect

Taxpayers: [REDACTED]

EIN: [REDACTED]

ISSUE

Whether the holding in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996) can be extended to the factual context presented by [REDACTED] taxable year.

CONCLUSION

The holding does apply to [REDACTED]'s [REDACTED] taxable year. Thus, it was on [REDACTED] that \$ [REDACTED] of [REDACTED]'s [REDACTED] deficiency became due and unpaid, on [REDACTED] that \$ [REDACTED] became due and unpaid, on [REDACTED] that \$ [REDACTED] became due and unpaid and on [REDACTED] that the final \$ [REDACTED] became due and unpaid.

FACTS

The facts recited herein are taken from the documents forwarded to our office, primarily claims written by the representative of the taxpayers. We have based our advice upon our understanding that you have verified those facts. We have also assumed that you have scrutinized the taxpayers' transcripts of account and Forms 2220 and evaluated them in relation to the regulations under I.R.C. § 6655 in order to verify when and whether the credit elect or portions thereof must be applied.

[redacted] [hereinafter referred to as [redacted]] were calendar year taxpayers in [redacted]. Pursuant to a valid extension, they filed their [redacted] U.S. Corporation Income Tax Return, Form 1120, on [redacted]. [redacted] elected to have their refund in the amount of \$ [redacted] credited to their estimated tax payments for their [redacted] taxable year. They did not attach a statement to their return designating the installment to which they wanted the overpayment applied. Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service retroactively applied the overpayment to the first installment of [redacted]'s estimated tax payments for their [redacted] taxable year which had been due on [redacted].

The following chart, prepared by the taxpayers' representative in [redacted], reflects the installment payments that they claim were due from [redacted] for their taxable year [redacted] in order for them to avoid the addition to the tax pursuant to I.R.C. § 6655, the payments that were actually made and the applications of the credit elect that were needed to avoid the addition to the tax:

	[redacted]	[redacted]	[redacted]	[redacted]
INSTALLMENT DUE	\$ [redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]
AMOUNT PAID	\$ [redacted]	\$ [redacted]		\$ [redacted]
OVERPAID	(\$ [redacted])	(\$ [redacted])		
UNDERPAID			\$ [redacted]	\$ [redacted]
OVERPAID [redacted] USED			(\$ [redacted])	
OVERPAID [redacted] USED			(\$ [redacted])	
CREDIT ELECT UTILIZED			(\$ [redacted])	(\$ [redacted])
UNUSED CREDIT ELECT				(\$ [redacted])

Thus, \$ [redacted] of the credit elect was needed in order to fully pay the third installment, \$ [redacted] was needed in order to pay the fourth installment and \$ [redacted] of the credit elect was not needed to pay any of the installments.

On [redacted], the Service assessed a deficiency in income tax against [redacted] for their [redacted] taxable year in the amount of \$ [redacted]. The Service also assessed interest on the deficiency in the amount of \$ [redacted]. In computing the

interest, the Service used [REDACTED] as the date on which interest began to run on the portion of the deficiency that exceeded the credit elect and [REDACTED] as the date on which interest began to run on the remainder of the deficiency. The taxpayer made advanced payments of the deficiency and interest.

On [REDACTED], the Service abated tax from the taxpayers' [REDACTED] taxable year in the amount of \$ [REDACTED]. It also abated interest and credit interest but we do not know how the interest was computed.¹

On [REDACTED], [REDACTED] filed a claim for refund of overcharged deficiency interest in the amount of \$ [REDACTED] (which, according to them, included overpayment interest) based on the decision in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996). In early [REDACTED], [REDACTED] filed a second claim for refund of overcharged interest in the additional amount of \$ [REDACTED] based on the decision in Sequa Corporation v. United States, (DC S.D.N.Y. June 10, 1998). Combining the impact of both the May and Sequa decisions on the "use of money" principles, they claimed that the correct start date for deficiency interest purposes on the \$ [REDACTED] general adjustment portion left after the subsequent tax decrease of \$ [REDACTED] is as follows:
[REDACTED] on \$ [REDACTED] and [REDACTED] on \$ [REDACTED].²

On [REDACTED], the Service allowed the claim [REDACTED] had made on [REDACTED] and abated interest from Ethyl's [REDACTED] account in the amount of \$ [REDACTED] and credit interest in the amount of \$ [REDACTED], for a total of \$ [REDACTED].

The statute of limitations for the taxpayers' [REDACTED] taxable year remains open under extension and examination of that year is ongoing.

¹ Because there was no disparity between the rate of interest paid on overpayments and that paid on underpayments in [REDACTED], interest netting is not an issue in this case.

² We believe that the taxpayer has made an error in their computations. Also, we have not necessarily condoned the assumption made by [REDACTED] that the overpayment credited to them on [REDACTED] should have been applied to the estimated tax installments that provide them the greatest benefit. See discussion on page 6, supra.

ANALYSIS

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that, when a taxpayer claims a credit elect on a return, filed on either the original due date or extension, and the credit is applied in full against an installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of the installment, for that part of the deficiency equal to or less than the credit elect, and from the original due date of the return on the remaining deficiency amount exceeding the credit elect. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), which holds that interest under Code section 6601(a), can be charged only when the tax is both due and unpaid. Thus, once the credit elect is used to pay the succeeding year's estimated tax, the prior year's tax becomes unpaid for purposes of section 6601(a), and deficiency interest begins to run. Prior to that date, the government has had the use of the taxpayer's funds with respect to the prior year's tax, and interest may not be charged.

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 return to the succeeding year's estimated tax liability, but did not attach a statement to the return, indicating the installment to which the Service should apply the credit. A deficiency was determined for the 1983 year, and interest was assessed from the due date of the first installment in accordance with Rev. Rul. 88-98. The taxpayer, however, had made sufficient payments of estimated tax for the first and second quarterly installments of 1984, to avoid the addition to tax imposed by Code section 6655 for these quarters.³ The court concluded that the Service's application of the taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of taxpayer's money from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the credit elect was not needed to satisfy any installment of estimated tax due during that period.

In light of the May Department Stores decision, the Service has reconsidered the manner in which deficiency interest is

³ Code section 6655 imposes a penalty on corporations that fail to pay their estimated taxes on a quarterly basis. The penalty equals the amount of interest, at the rate established under section 6621, that has accrued on the amount of underpayment for the period the estimated tax was underpaid. Id., § 6655(a) & (b).

computed under section 6601(a), when the taxpayer makes an election to credit the overpayment to the succeeding year's estimated taxes. When such election is made, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated income tax under Code sections 6654 and 6655.⁴ Thus, the Service will assess interest on a subsequently determined deficiency from the date the credit is applied to the succeeding year's estimated taxes. In all situations, the estimated tax rules in effect for the tax year in which the credit is used will determine the amount of estimated taxes due, and thus, the amount of the credit needed to satisfy the quarterly installments.⁵ The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.

Where the overpayment is not needed to satisfy any installment of estimated tax, the overpayment should be treated as a payment of income taxes for the next succeeding year. Section 6513(d) provides that, if any overpayment of income tax is claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of income tax for the succeeding taxable year (whether or not claimed as a credit on the return of estimated tax for such succeeding taxable year) and no claim for credit or refund shall be allowed for the taxable year in which the overpayment arises. Income tax paid before the date prescribed for payment is considered paid on the due date, I.R.C. § 6513(a), and Code section § 6151 provides that the date prescribed for payment of income tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). Accordingly, it is on the unextended due date of the next succeeding year's return that the unused credit is

⁴ Code section 6654 imposes a penalty on individuals failing to pay estimated tax.

⁵ While the Action on Decision with respect to May Department Stores did not address the situation where a taxpayer splits the credit elect between installments of estimated tax, the estimated tax rules allow the credit elect to be applied as needed to satisfy all or part of the amount payable on the quarterly installment due date. When a credit elect is split among various installments, the taxpayer will use its money at differing times to satisfy estimated tax liabilities. Accordingly, we conclude that deficiency interest computations that take into account the manner in which the credit elect was split among installments of estimated tax are consistent with both May Department Stores and Avon Products.

treated as a payment for purposes of computing interest on the subsequently determined deficiency amount corresponding to the unused credit elect. Further, any overpayment of income taxes with respect to the succeeding year that would result from this application of the credit elect would also run interest from the due date of the succeeding year's return, under Code section 6611(a) and (d). Thus, an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year, which is not needed to satisfy estimated taxes, should be treated as a payment against the subsequent year's income tax as of the due date of that year's return.

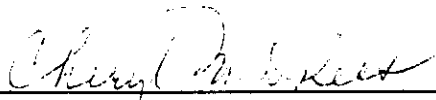
According to this approach, it was on [REDACTED] that \$[REDACTED] of [REDACTED]'s [REDACTED] deficiency became due and unpaid, on [REDACTED] that \$[REDACTED] became due and unpaid, on [REDACTED] that \$[REDACTED] became due and unpaid and on [REDACTED] that the final \$[REDACTED] became due and unpaid.

There is one other component of the interest computations regarding which you did not ask our advice. Combining the deficiency assessed on [REDACTED] with the abatement of tax on [REDACTED], leaves a net deficiency that was due from [REDACTED] for its [REDACTED] taxable year in the amount of \$[REDACTED]. This appears to be inconsistent with the sum given in [REDACTED]'s second claim. See page 3, infra.⁶ The question arises as to whether we take this net deficiency from the sums which, under the "use of money" principles, the Government had for the longest or the shortest period of time. [REDACTED] chose to compute its claim by taking the deficiency from the installments that were most advantageous to them. Since this issue does not relate to the May Department Stores or Sequa cases, and you have not requested our advice in its regard, we have not addressed this issue. If you would like our opinion on the matter, please let us know.

If we may be of further assistance, please contact me at (804) 771-2885. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) and to the Office of Assistant Chief Counsel (Field Service) for mandatory 10-day post review. To

⁶ It may be that it merely appears to be inconsistent because we have seen only the second of two claims [REDACTED] filed.

ensure that the National Office has had sufficient time to review our advice, we request that you refrain from taking any action with respect to the taxpayers' claims prior to [REDACTED].



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cc: SER Assistant Regional Counsel (TL)
Assistant Chief Counsel (Field Service) (CC:DOM:FS)